

MINUTES

AUDIT SUBCOMMITTEE OF THE LEGISLATIVE MANAGEMENT COMMITTEE

The Audit Subcommittee of the Legislative Management Committee met in Room 303, State Capitol Building, Salt Lake City, Utah, February 16, 2004, from 1:00 p.m. until 2:10 p.m.

Committee Members Present:

Speaker Martin R. Stephens, Co-Chairman
President Al Mansell, Co-Chairman
Senator Mike Dmitrich
Representative Brent Goodfellow

Legislative Audit Staff:

Wayne L. Welsh, Auditor General
John Schaff, Deputy Auditor General
Rick Coleman, Audit Manager
Darin Underwood, Audit Supervisor
Janice Coleman, Audit Supervisor
David Gibson, Sr Performance Auditor
Brian Dean, Sr Performance Auditor
Lynda Maynard, Recording Secretary

Other Interested Parties:

Kim Christensen, Exec Director, Dept of Human Resource Management. (DHRM)
Jeff Herring, Deputy Director, DHRM
Robin Arnold-Williams, Director, Dept of Human Services
Jennifer Bingham, Human Resource Analyst, Dept of Health
Steven O. Laing, State Superintendent, State Office of Education
Patrick Ogden, Assoc Superintendent, USOE
Scott Steele, Dir of Quality and Internal Auditing, DWS
Sal Petilos, Director of Internal Audits, Dept of Administrative Services
Kevin Carter, Director, SITLA
Ruland Gill, SITLA Board of Trustees
S. Camille Anthony, Exec Director, Dept of Administrative Services (DAS)
Mike Chabries, Exec Director, Dept of Corrections(DOC)
Chris Mitchell, Deputy Director, DOC
Scott Carver, DOC
Linda Hull, UDOT

Melanie McDaniel
Helen M Merrinis
Paul Foy, *Associated Press*
Kirsten Stewart, *Salt Lake Tribune*
Kerry Jensen, *KSL TV*

1. Call to Order

Speaker Stephens called the meeting to order at 1:00 p.m.

2. Approval of Minutes

Senator Dmitrich made a motion that the minutes from the February 3rd meeting be approved. The motion passed.

3a. A Performance Audit of Statewide Employee Incentives

(Report #2004-04)

Presented by Darin Underwood, Audit Supervisor

Cash incentives—while granted on a lesser scale than the private sector—have long been used by state government agencies as a method for rewarding employee performance. However, concerns with incentive awards granted by state agencies were recently reported in the June 2003 limited review of incentive programs (ILR 2003-D, “Review of Tax Commission Employee Incentives and Performance Awards”). This report is in response to the legislative request to perform a follow-up statewide audit of employee incentives. Our objectives were to:

- Determine the extent to which state departments have given performance or incentive compensation in the form of cash or administrative leave.
- Evaluate whether such incentive awards are justified.
- Evaluate whether the awards are consistent with statutory provisions and administrative rules.
- Evaluate whether the awards are appropriate in a time of severe budget shortfalls.

We found that state agencies have reduced cash incentives. In fiscal year 2003, state agencies in Utah combined to grant just under \$3.1 million in cash incentives to employees, as a supplement to regular employee compensation. While this appears to be a sizeable amount of incentives to grant during a lean budget year, it also represents a 48 percent decrease from the \$5.9 million in cash incentives granted two years previous, in fiscal year 2001.

Our more limited review of incentives granted for the first half of fiscal year 2004 (July to December 2003) continues to show a downward trend. We forecast that fiscal year 2004 incentive totals could be about \$1.6 million, a 48 percent decrease from \$3.1 million in fiscal year 2003.

Our review of the cash incentives for fiscal year 2003 also shows:

- the state General Fund is the source of almost all incentives,
- the average incentive for an employee was under \$400,
- aggregate incentives amount to about 0.4 percent of the state's payroll (\$3.1 million incentives of over \$700 million in payroll).
- several agencies gave incentives to a majority of their employees.
- some agencies increased incentive spending since fiscal year 2001.

To further review the cash incentives in fiscal year 2003, we conducted detailed reviews of incentives in a sample of 740 state employees in nine state agencies. These nine agencies accounted for over 82 percent of the incentives granted in fiscal year 2003. We evaluated cash incentives based on criteria included in the Department of Human Resource Management's Incentive Award rule, and found:

1. Some incentives were not based on outstanding performance:
 - agencies granted sick leave incentives and retirement incentives which were not based on work,
 - agencies granted peer-to-peer awards for what appeared to be normal job duties, and
 - agencies granted "blanket" incentives (incentives offered to nearly every employee in a division, office, bureau, etc.).
2. Most incentive amounts were within spending limits set by rule.
3. Documentation varied widely among agencies. In many cases, documentation was not sufficient to show the incentive was based on exceptional effort.

We also used our nine agencies to review administrative leave (time off with pay) as a performance incentive in lieu of cash. It appears that leave incentives are awarded much less frequently than cash incentives. However, weaknesses in the tracking of leave incentives prevented us from providing reliable statewide information about the amount or trend over time of such incentives. Our sample revealed:

1. Similar to the cash incentives, documentation of incentive leave was often insufficient for us to determine if the leave was based on exceptional effort.
2. About 56 percent of "other administrative" (OA) leave—the category which contains incentive leave—is clearly not awarded as a performance incentive. We screened three types of leave to determine possible incentive leave: mis-coded funeral/military, Governor's holiday, and disciplinary leave.
3. Incentive leave is interpreted and applied inconsistently. We found several categories of possible incentive leave, and other leave that was apparently non-incentives.

Largely in response to our 2003 audit review, DHRM has already enacted rule changes for incentives leave. But, our sample reveals that there is still work to be done to improve DHRM rules and processes.

- Rules for incentive leave are unclear: Current rules do not include incentive leave in "Incentive Award"

rules for cash incentives.

- Many state agencies have granted incentives in fiscal year 2004 without an approved policy by DHRM.
- Agencies have incentive programs that are not based on exceptional effort, such as sick leave incentives and retirement incentives.
- Incentive rules lack documentation guidelines adequate to show cost savings and/or exceptional effort.

In response to these findings we make the following recommendations to the Department of Human Resource Management (DHRM).

1. We recommend DHRM clarify the rules for “incentive leave” by including the requirements of awarding such leave as part of its Incentive Award Rule.
2. We recommend DHRM consider limiting, in rule, the number of incentive leave hours granted per person, per fiscal year.
3. We recommend DHRM inform agencies who have granted incentives in fiscal year 2004 while having unapproved incentive policies, that they are not in compliance with state rules.
4. We recommend that DHRM review the validity of incentive award programs that do not appear to be based on job performance, such as sick leave incentives and retirement incentives. We further recommend that if DHRM determines that factors other than job performance should qualify for incentive awards, that rules be amended to clearly allow for these awards.
5. We recommend DHRM provide more guidelines on acceptable documentation for incentives to ensure that evidence of cost savings and/or exceptional effort is provided.

Discussion following presentation:

Kim Christensen, Executive Director, Department of Human Resource Management (DHRM), responded to the recommendations made in the audit as follows:

- Recommendation #1 - When DHRM puts together their rules, effective on July 1, 2004, they will evaluate and consider adding criteria for granting incentive leave.
- Recommendation #2 - DHRM will consider placing a limit on the number of incentive leave hours granted per person, per fiscal year.
- Recommendation #3 - DHRM will notify agencies, who have not submitted their incentives policies for approval, that they are out of compliance.
- Recommendation #4 - DHRM will review the validity of incentive award programs to determine their appropriateness and amend the policies where necessary.

- Recommendation #5 - Although documentation for cash awards is required, DHRM will consider adding documentation requirements to cover incentive leave.

Mr. Christensen concluded by telling the Audit Subcommittee that incentives play an important role in making a difference in a tight market and that incentives need to be done in a proper and very conservative way.

Kevin Carter, Director of School and Institutional Trust Lands Administration (SITLA), explained that they use two processes for their incentive awards: 1) for upper management and, 2) for all other employees. Mr. Carter said that the upper management bonus is an item that is appropriated by the Legislature and the other bonus portion is from turn-over savings and other savings in the agency.

Ruland Gill, a member of the board of trustees for SITLA, said that they use a budget process for the upper management contract process and incentive compensation. Mr. Gill explained that the budget process has three steps—

- Step 1 - Preliminary budget
- Step 2 - Legislative appropriations
- Step 3 - Current business circumstances

Mr. Gill continued by telling the Audit Subcommittee that there are monetary and non-monetary portions to their incentive program and that their process is set by the board of trustees.

Motion: Senator Dmitrich made a motion that the **Performance Audit of Statewide Employee Incentives** (Report #2004-04) be referred to the Economic Development and Human Resources Joint Appropriations Subcommittee and the House and Senate Government Operations Standing Committees. The motion passed unanimously.

3b. A Follow-up of \$23.7 Million Textbook Supplemental Expenditures by Education (Report #2004-03)

Presented by Janice Coleman, Audit Supervisor

The effectiveness of the \$23.7 million textbook supplemental provided by the 2001 Legislature does not appear to have been maximized. First, district textbook expenditures did not match the state's textbook expenditure efforts. Second, some districts may have used supplemental funds for purposes other than textbooks. Third, supplemental textbook funds were proportionally allocated—although auditors recommended a different methodology. Perhaps as a result of these three concerns, half of the 2000 textbook shortage was satisfied by 2003. The Utah State Office of Education (USOE) reported unmet textbook needs in October 2003; however, the methodology used for the estimate appears flawed.

District Textbook Expenditure Effort Did Not Match State Effort. Of the four years reviewed (2000 through 2003) district textbook expenditures were the lowest in fiscal year 2002, the year in which the supplemental was spent. This expenditure pattern was unexpected given the expressed concerns surrounding

textbooks. The USOE explains that it was unrealistic to expect districts to increase their spending on textbooks in 2002 for the following reasons: 1) textbooks were only one of several critical spending needs, and 2) districts were not appropriated additional funding for ongoing textbook needs. The USOE also points out that, with the supplemental expenditure, spending for textbooks in 2002 nearly doubled over the prior year. Regardless, we believe districts should have increased, not decreased, their textbook expenditures to complement large supplemental funds. For whatever reason, this did not occur.

Some Districts May Have Used Supplemental for Purchases Other Than Textbooks.

When districts received their portion of the textbook supplemental, some districts indicated that they did not have significant textbook needs. These districts suggested that they would use supplemental funds for other needs. Ironically, two of these districts reported unmet textbook needs in 2003. Because of the nature of this follow-up audit, we were unable to pursue this area in detail. However, we are aware that some districts reportedly used the supplemental for . . . The effectiveness of the \$23.7 million textbook supplemental provided by the 2001 Legislature does not appear to have been maximized. First, district textbook expenditures did not match the state's textbook expenditure efforts. Second, some districts may have used supplemental funds for purposes other than textbooks. Third, supplemental textbook funds were proportionally allocated—although auditors recommended a different methodology. Perhaps as a result of these three concerns, half of the 2000 textbook shortage was satisfied by 2003. The Utah State Office of Education (USOE) reported unmet textbook needs in October 2003; however, the methodology used for the estimate appears flawed.

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Supplemental Money Allocated Proportionally. The 2000 report recommended against using a proportionate methodology (i.e., one based on relative number of Weighted Pupil Units (WPU's)) to allocate the textbook supplemental. Proportionate allocation does not correspond well to classroom needs—the basis of the \$23.7 million supplemental. However, the Legislature supported the methodology and the USOE proportionally allocated the textbook supplemental. Using one method to develop the estimate (i.e., specific classroom needs) and another method to allocate the supplemental (i.e., number of WPU's in elementary, junior high, and high school), does not promote maximum effective usage.

Half of 2000 Textbook Need Satisfied. Half of the textbook needs identified in May 2000 were satisfied by April 2003. We estimated the percentage by re-interviewing a sample of teachers from the original survey. Analysis of textbook need satisfaction should have included textbook needs as identified by school districts. Unfortunately, though required by the *Utah Code*, the USOE did not request and, with

few exceptions, the districts did not supply specific textbook needs. Comparisons of district-identified textbook needs with teacher-identified needs could not be made.

USOE Methodology for 2003 Unmet Textbook Need Appears Flawed. The USOE did not provide adequate guidance to school districts for a reliable 2003 unmet textbook needs estimate. As a result, districts adopted varying, and subjective methodologies. This lack of guidance caused one large district to misinterpret a critical question causing a \$2.5 million error to the USOE's \$9.5 million textbook estimate. Finally, the USOE's methodology produced two estimates of 2003 unmet textbook need which caused confusion. teacher training, library books, and regularly scheduled textbook adoptions.

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Discussion following presentation:

Speaker Stephens asked Janice if she knew how the distribution of the appropriation for textbooks was changed from the original bill.

Janice said she believed there was an amendment to the original bill that mentioned doing the appropriation of the textbook supplemental expenditure by 'need'. Janice added that 'need' was defined by the State Office of Education as being a proportionate basis.

Steven O. Laing, State Superintendent, State Office of Education, addressed the distribution issue. He said that the USOE adopted a distribution formula that recognized the need, as outlined in the original audit, and then distributed the money based on the need of elementary and secondary schools; then, the money went to the districts in a proportionate manner so that those districts who had already made

substantial efforts were not penalized for having made sacrifices in other areas. However, Mr. Laing acknowledged that the formula they used had an error.

In conclusion, Mr. Laing said that the appropriation made a great dent in the textbook needs problem but that it is an ongoing problem that is indicative of a system that is having to balance, on any given year, the stresses around the funding that is available to them.

Speaker Stephens expressed his concern and disappointment that the textbook funds were not handled the way they were set up to be handled; thus, the same problem exists today that the expenditure for textbooks was supposed to solve.

Patrick Ogden, Associate Superintendent, Utah State Office of Education, explained that the requirement set forth to obtain a report from each district giving the needs of textbooks was followed the first year. Because USOE felt that the textbook needs had been met, the needs report from each district was not asked for during the second year and the districts did not provide these reports because USOE did not feel that it was necessary as the need had been abated. However, USOE did ask for the reports this year and most districts supplied the reports.

Mr. Ogden said that the state-wide plan to provide adequate textbooks for students had been submitted to the Legislature but the appropriation was not made. He also said that USOE reviewed the plan and made modifications, where necessary, the first year.

Motion: Speaker Stephens made a motion that the **Follow-up of \$23.7 Million Textbook Supplemental Expenditures by Education** (Report #2004-03) be referred to the Public Education Joint Appropriations Subcommittee, the Executive Appropriations Committee, and the House and Senate Education Standing Committees. The motion passed.

4. Audit Requests

Wayne L. Welsh, Auditor General, told the members of the Audit Subcommittee that there was no need to discuss the audits in process at this time as there would be more new audit requests after the end of the General Session.

5. Adjournment

President Mansell adjourned the meeting at 2:10 p.m.